Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 04 MAY 2006

Message Text

CONFIDENTIAL

PAGE 01 ROME 02315 111902Z

42
ACTION EUR-12

INFO OCT-01 ISO-00 EURE-00 AID-05 CEA-01 CIAE-00 COME-00

EB-07 EA-07 FRB-03 INR-07 IO-11 NEA-10 NSAE-00

OPIC-03 SP-02 TRSE-00 CIEP-01 LAB-04 SIL-01 OMB-01

L-03 PA-01 PRS-01 USIA-06 SS-15 NSC-05 /107 W
---------- 033577
P R 111745Z FEB 76
FM AMEMBASSY ROME
TO SECSTATE WASHDC PRIORITY 5687
USMISSION OECD PARIS

C O N F I D E N T I A L ROME 2315

PASS TREASURY AND FRB

E.O. 11652: GDS
TAGS: EFIN, IT
SUBJECT: WORKING PARTY 3 DISCUSSION OF ITALIAN SITUATION

REF: (A) USOECD 3865, (B) USOECD 3918, (C) ROME 1678,
(D) ROME 1945, (E) ROME 204, (F) ROME 2256

SUMMARY. FOLLOWING ARE EMBASSY COMMENTS ON SPECIFIC SUBJECTS CONTAINED IN OECD SECRETARIAT DOCUMENTS AS CITED REFS A AND B. END SUMMARY.

1. WEAKNESS OF LIRA. EMBASSY AGREES THT FALL OF GOVERNMENT WAS NOT SOLE CAUSE OF SPECULATIVE ATTACK ON LIRA, ALTHOUGH IT WAS CERTAINLY VERY IMPORTANT AND MOST PROXIMATE CAUSE. CONFIDENCE HAD ALSO BEEN UNDERMINED, TO SOME EXTENT, BY PRESS REPORTS OF DECLINE IN OFFICIAL RESERVES LATE IN 1975 AND OF POOR PROSPECTS FOR NEW FOREIGN BORROWING BY ITALY AND BY UNDERLYING COST INFLATION.

2. TIGHTER MONETARY AND BUDGET POLICIES. WHILE TIGHTER MONETARY MEASURES ALREADY TAKEN (REF C AND D) AND PROPOSED
CONFIDENTIAL

CONFIDENTIAL

PAGE 02 ROME 02315 111902Z

MORE RESTRICTIVE BUDGETARY POLICIES (REF E) SHOULD BE

Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 04 MAY 2006

Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 04 MAY 2006

MARGINALLY HELPFUL IN RESTORING CONFIDENCE, MOST IMMEDIATE
PROBLEM TO BE RESOLVED IS FORMATION OF NEW GOVERNMENT WITH
CREDIBLE ECONOMIC PROGRAM. IN EMBASSY OPINION, EVEN IF NEW
ONE-PARTY GOVERNMENT SURVIVES UNTIL SPRING OF 1977, WHICH IS
UNLIKELY, LACK OF BROAD POLITICAL CONSENSUS WILL INHIBIT
APPROPRIATE GOVERNMENT ACTION ON FUNDAMENTAL ECONOMIC PROBLMES,
THUS CONTRIBUTING TO ANY WEAKNESS IN ITALIAN BALANCE OF
PAYMENTS CAUSED BY UNDERLYING ECONOMIC FACTORS.

3. FINANCIAL POSITION OF ENTERPRISES. PROPOSED INDUSTRIAL
RESTRUCTURING MEASURESCOULD CAUSE SUBSTANTIAL INCREASE
IN BUDGETARY EXPENDITURES. HOWEVER, SUCH EXPENDITURES MAY
STILL BE JUSTIFIABLE. INCREASE IN CASH BUDGET DEFICIT MIGHT
BETTER BE DEALT WITH THROUGH IMPROVED TAX COLLECTIONS AND
REDUCED RATE OF INREASE IN CURRENT EXPENDITURES SUCH AS
FOR WAGES AND SALARIES. EMBASSY HAS NEVER SHARED APPARENT
OECD SECRETARIAT ENTHUSIASM FOR "FISCALIZATION" OF SOCIAL
COSTS BY GOVERNMENT, WHICH MERELY SHIFTS BURDEN FROM BUSINESS
TO GOVERNMENT BUDGET. BASIC PROBLEM REAMINS EXCESSIVE
INCREASE IN SOCIAL COSTS. TO EXTENT BUSINESS IS PERIODI-
CALLY RELIEVED OF THESE COSTS BY GOVERNMENT, ITS RESISTANCE
TO FURTHER EXCESSIVE INCREASES IN SUCH BENEFITS WILL BE
REDUCED.

4. WAGE NEGOTIATIONS. PROPOSED GOVERNMENT ECONOMIC
PROGRAM (REF E) ALREADY CONTAINS MODEST PROPOSALS FOR
LIMITING WAGE AND SALARY INCREASES. ROUGH (OPTIMISTIC)
EMBASSY ESTIMATE OF EFFECT OF PROPOSAL (REF F) SUGGESTED
THAT REDUCTION IN WAGE BILL MIGHT BE FAIRLY PERCEPTIBLE
IF CONTROLS WERE APPLIED ON INCOME ABOVE 5 MILLION
LIRE (REDUCTION IN WAGE BILL INCREASE FROM ABOUT 18 TO
ABOUT 13 PERCENT). HOWEVER, LATEST INFORMATION INDICATES
THAT UNIONS MAY ONLY GO ALONG WITH LIMITATIONS APPLICABLE
TO INCOME OF 10 MILLION LIRE OR MORE. ALSO, EMBASSY
ASSUMPTIONS IN REF F MAY HAVE BEEN TOO OPTIMISTIC AS TO
RATES OF SALARY INCREASES FOR DEPENDENT AND INDEPENDENT
LABOR IN ABSENCE OF INCOMES POLICY. IN ADDITION, IF
"INDEPENDENT" LABOR BY DEFINITION DOES NOT INCLUDE ANY
"MANAGERS," THEN EFFECT OF PROPOSALS WOULD BE EVEN LESS
PERCEPTIBLE. BY MAKING ALL THESE MORE PESSIMISTIC
CONFIDENTIAL

ASSUMPTIONS, INCREAS IN WAGE BILL IN 1976 WOULD BE 21
PERCENT BEFORE TAKING ACCOUNT OF PROPOSED MEASURES AND
19 PERCENT AFTERWARD. UNIONS ARE TAKING VERY STRONG
POSITION AGAINST ANY LEGISLATED CONTROSL ON GROUPS
THIS WOULD INTERFERE WITH FREEDOM OF COLLECTIVE
BARGAINING. THEY HAVE, HOWEVER, SHOWN SOME WILLINGNESS
TO REDUCE CONTRACT WAGE DEMANDS IN VIEW OF DIFFICULT
ECONOMIC SITUATION. NONETHELESS, IF COST OF LIVING RISES

Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 04 MAY 2006

Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 04 MAY 2006

BY ABOUT 14 PERCENT, AUTOMATIC COST OF LIVING ADJUSTMENT WOULD BE 12 PERCENT AND ADDITIONAL AUTOMIATIC INCREASES MIGHT ADD 3 TO 4 PERENT, SO THAT WAGE AND SALARY INCREASE FOR UNIONIZED WORKERS WOULD LIKELY RISE BY AROUND 16 PERCENT WITHOUT ANY NEW NEGOTIATED WAGE INCREASES.

5. INERNATIONAL SUPPORT OF LIRA. EMBASSY INTERPRETS SECRETARIAT REFERENCE TO "INTERNATIONAL ACTION DESIGNED TO SUPPORT LIRA" AS REFERENCE TO SOME KIND OF FINANCIAL PACKAGE TO PERMIT BANK OF ITALY TO RESUME EXCHANGE MARKET INTERVENTION. WHILE MODEST AMOUNT OF NEW FINANCING WILL BE REQUIRED TO LEND SOME CREDIBILITY TO RESUMED INTERVENTION, EMBASSY DOES NOT BELIEVE THAT AMOUNTS WHICH COULD BE OBTAINED WOULD BE SUFFICIENT TO GREATLY REASSURE EXCHANGE MARKET DEALERS. IN ANY CASE, IN OUR OPINION (AND, WE BELIEVE, IN OPINION OF HIGH BOI OFFICIALS), LARGE SCALE FOREIGN BORROWING TO SUPPORT INTERVENTION WOULD BE MISTAKE, SINCE IT WOULD CREATE ADDITIONAL DEBT BURDEN AND MIGHT TEMPT CENTRAL BANK ONCE AGAIN TO ENGAGE IN EXCESSIVE INTERVENTION RATHER THAN PERMITTING UNDERLYING MARKET FORCES TO WORK.

6. EXCHANGE RATE POLICY. IN EMBASSY OPINION, BOI WITHDRAWAL OF SUPPORT FROM EXCHANGE MARKET WAS NOT ONLY UNAVOIDALBE BUT DESIRABLE, GIVEN LACK OF CONFIDENCE IN ITALY AND TYPICAL PESSIMISM OF ITALIAN PUBLIC ABOUT LIRA. THERE IS REAL POSIBILITY THAT DEPRECIATION OF LIRA MAY INITIALLY EXCEED THAT NEEDED TO CLEAR THE MARKET. PRESUMABLY, ANY "OVER-SHOOT" EFFECT WOULD BE SELF-CORRECTING. IN ANY CASE, DEPRECIATION OF LIRA MUST BE ADEQUATE NOT ONLY WITH REGARD TO CURRENT ACCOUNT POSITION BUT IT ALSO MAY HAVE TO COMPENSATE FOR CAPITAL
CONFIDENTIAL

CONFIDENTIAL

OUTFLOWS, WHICH HAVE HISTORICALLY BEEN RATHER LARGE AND PERSISTENT. EXTENT OF DEPRECIATION REQUIRED FOR THESE TWO PURPOSES MAY NOT BE PLEASING TO SOME OF ITALY'S TRADING PARTNERS. EMBASSY IS PUZZLED BY REFERENCE IN SECRETARIAT DOCUMENT (REF B) TO BRINGING "RATE BACK TO AN APPROPRIATE LEVEL AFTER THE CRISIS IS RESOLVED." EXCEPT FOR ANY OVERSHOOTING OF THE MARK DUE TO CURRENT LOW LEVEL OF CONFIDENCE, EMBASSY WOULD NOT EXPECT RATE TO APPRECIATE AFTER POLTICAL CRISIS HAS BEEN RESOLVED. MEASUREMENT OF COMPETITIVE STRENGTH OF LIRA IS DIFFICULT, BUT ROUGH EMBASSY CALCULATIONS INDICATE THAT DEPRECIATION TO DATE HAS NOT CREATED EXCESSIVELY STRONG LIRA IN ITALY'S MAJOR MARKETS (SEE PARA 3 REF F). ADMITTEDLY, EARLIER EMBASSY CALCULATIONS OF COMPETITIVENESS OF ITALIAN EXPORTS IN DOLLAR TERMS IN THIRD MARKETS DID

Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 04 MAY 2006

Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 04 MAY 2006

SHOW RELATIVELY STRONGER POSITION THAN THAT SHOWN IN
LOCAL CURRENCIES FOR COUNTRIES CITED IN REF F. THIS
POSITION IN THIRD MARKETS HAS PRESUMABLY BEEN FURTHER
IMPROVED BY LATEST DEPRECIATION OF LIRA. HOWEVER, PART
OF CURRENT DEPRECIATION OF LIRA MAY BE IN ANTICIPATION
OF CONTINUED HIGHER COST AND PRICE RISES IN ITALY THAN IN
ITS MAJOR TRADING PARTNERS. EMBASSY DOES NOT HAVE GOOD INFOR-
MATION ON EXTENT OF IMPACT ON INTERNAL PRICES OF LIRA DEPRECIATION
BUT THINKS SECRETARIAT FIGURE OF 4.5 PERCENT SEEMS REASONABLE.

VOLPE

CONFIDENTIAL

NNN

Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 04 MAY 2006

Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: CREDIT CONTROLS, COMMITTEE MEETINGS, PRIME INTEREST RATES, BANKS, ANTIINFLATIONARY PROGRAMS
Control Number: n/a
Copy: SINGLE
Draft Date: 11 FEB 1976
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: coburnhl
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1976ROME02315
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Film Number: D760052-0320
From: ROME
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1976/newtext/t19760259/aaaabzvg.tel
Line Count: 180
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION EUR
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 4
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: 76 ROME 1678
Review Action: RELEASED, APPROVED
Review Authority: coburnhl
Review Comment: n/a
Review Content Flags:
Review Date: 16 APR 2004
Review Event:
Review Exemptions: n/a
Review History: RELEASED <16 APR 2004 by greeneet>; APPROVED <11 AUG 2004 by coburnhl>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
04 MAY 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: WORKING PARTY 3 DISCUSSION OF ITALIAN SITUATION
TAGS: EFIN, IT
To: STATE OECD PARIS
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 04 MAY 2006